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TAGS: ECON EINV ETRD EFIN SR
SUBJECT: SERBIA: 2008 BUDGET REBALANCE ADOPTED

SUMMARY

¶1. The Serbian Parliament adopted a rebalanced 2008 budget on November 4, with 127 to 17, with 9 abstentions. The rebalance adjusted for higher than projected 2008 revenues and expenditures, and changed government priorities from the government formed in July. Revenues and expenditures are up by 0.4% and 0.6% of GDP respectively over the original 2008 budget, thus increasing deficit by 0.2% of GDP. The Finance Minister assessed the rebalance as a reasonable compromise between development and social goals given the political circumstances. The opposition rejected the rebalance as "wasteful and harmful" to the state. The rebalance includes money for damages to our Embassy during the February 21 riots and MFA sources told us that we should receive payment very soon. END SUMMARY.

Expenditures/Revenues above Projections

¶2. The Serbian Parliament adopted a rebalanced 2008 budget on November 4, 2008 by a narrow majority of 127 to 17, with 9 abstentions (the budget needed support from half of the 250 parliamentarians to pass). Many opposition members did not participate in the session leaving a skewed result that only crossed the threshold needed for adoption by one vote. The budget rebalancing measure increased spending based on higher than projected revenues and changed the expenditure structure to reflect the new government's priorities (such as infrastructure improvement, financial incentives for strategic investments, increasing pensions, etc.)

Revenues, Expenditures Up By 0.4% and 0.6% of GDP
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¶3. The rebalanced budget, compared to the original 2008 budget, increased total revenues from $9.92 billion to $10.08 billion or 0.4% of GDP, mostly due to higher than expected revenues from income tax, corporate profit tax, and customs. Total expenditures increased from $10.56 billion to $10.80 billon or 0.6% of GDP mostly due to increased subsidies, and pensions. The total budget deficit increased from $635 million to $711 million or 0.2% of GDP. Finance Minister Dragutinovic characterized the deficit as "not a statistically significant increase." The government will finance the deficit through new borrowing. Key expenditure increases included: transfers to the pension fund increased to fund the extraordinary 10% pension increase, subsidies to agriculture, investments for joint venture with Fiat, and increased spending for construction of beltway around Belgrade and Corridor 10 highway.

Finance Minister: Reasonable Compromise

¶4. Dragutinovic said at an October 24 press conference that the budget was a "reasonable compromise given the political circumstances." She added that the "rebalance harmonized revenues and expenditures with development and social priorities of the new

government and has not additionally endangered macroeconomic stability." She added that the rebalance respected basic fiscal rules - deficit below 3% of GDP, state borrowing only for investment, and public debt below 40% of GDP.

Money for Embassy Damage Included

¶5. The budget rebalance included additional funds for the Ministry of Foreign Affairs to settle bills for embassy damages during the February 21 riots. Our MFA contacts told us on November 6 that they were awaiting the official gazette with the budget rebalance law. The published law would give them authority to move ahead with payment either immediately, or in seven days. The Ministry did not expect further delay in processing the payment beyond a few days to complete the funds transfer.

COMMENT

¶6. The 2008 rebalance follows the trend of expansive fiscal policies of the last several years. The government faces a difficult challenge to adjust economic policies to reflect the realities following the global economic crisis in the upcoming 2009 budget. Many economists, including National Bank of Serbia Governor Jelasic, say that the state has to restrict growth of expenditures. Prime Minister Cvetkovic told us on October 14 that the government would severely cut consumption in 2009. The IMF hopes to sign an agreement on a stand-by arrangement as soon as November 10. The IMF delegation told us on November 6 that they were demanding Serbian government agreement to either freeze in government expenditures, or roll-back of the 10% pension increase. This will be a bitter pill for the new Serbian government, eager to deliver on election

promises, but government officials tell us they hope to use the IMF as a scapegoat for the tough measures. While the pensioners party publicly admitted their demand for pension increases to 70% of averages wages would have to be put off until 2010, they did not give up on their long-term goals. The IMF and every economist we have spoken with agree that growth in pensions in Europe's oldest population would not be sustainable and could crush the state. The government's ability to find the political will to restrict spending will be critical to demonstrating credibility to financial markets in the coming months. End Summary.

MUNTER